

### Strong Growth in the Third Quarter

In early September, our third quarter real GDP forecast was 3%. The consensus was 2.2%. Since then, we have upped our forecast to 4%. So has the consensus – to 3.1%. The data will be released on Wednesday.

Surprisingly, our forecast could be too low. If the Bureau of Economic Analysis adopts robust estimates for inventories, trade and business construction, Q3 real GDP could be stronger. To the extent the quarter is above our forecast, we would expect an offset in Q4. Nonetheless, after a 0.6% growth rate in Q1, real growth has re-accelerated to its 3.5% trend. When this fact is realized, it will send shudders through the pessimistic crowd gathered around the water cooler. Our “add-em-up” forecast is laid out in the paragraphs below.

**Personal Consumption:** Consumption through August and retail sales in September suggest real consumption will grow at about a 3.6% rate in Q3. With consumption accounting for 70% of GDP, real PCE growth in Q3 will contribute about 2.5 percentage points to real GDP growth (70% of 3.6 equals 2.5).

**Housing:** Residential construction is by far the largest drag on the economy. Our models suggest

residential construction declined at a 17% annual rate in Q3. Given that the sector makes up 4.8% of GDP, this translates into a drag of 0.8 percentage points on real GDP growth (4.8% of -17 equals -0.8).

**Business Investment:** Shipments of capital goods, ex-defense and aircraft, increased at an inflation-adjusted 4% annual rate in Q3. If we cautiously assume business building grows at a 9% rate, which implies a drop in business construction in September, this puts the business investment contribution to GDP at 0.6 points.

**Trade:** The inflation-adjusted trade deficit has been declining for the past year. Given the progress already made in July and August, even if we assume no further gains in September (data not yet available) trade would still add 1.1 points to real GDP growth in Q3.

**Inventories:** Despite data suggesting a potentially very large inventory build in Q3, we cautiously assume inventories add only 0.2 points to Q3 real GDP growth.

**Government:** In the past ten years, on average, government spending has accounted for 0.4 points of GDP growth. We assume this trend continues.

**Third Quarter Total: = 4.0%**

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
10-31 / 7:30 am	Q3 GDP Advance	3.1%	<b>4.0%</b>		3.8%
7:30 am	Q3 GDP Chain Price Index	2.0%	<b>2.3%</b>		2.6%
7:30 am	Q3 Employment Cost Index	0.9%	<b>1.0%</b>		0.9%
8:45 am	Chicago PMI - Oct	53.0	<b>53.0</b>		54.2
9:00 am	Construction Spending - Sep	-0.4%	<b>-0.3%</b>		+0.2%
11-1 / 7:30 am	Initial Claims - Oct 27	325K	<b>325K</b>		331K
7:30 am	Personal Income - Sep	+0.4%	<b>+0.4%</b>		+0.3%
7:30 am	Personal Spending - Sep	+0.4%	<b>+0.5%</b>		+0.6%
9:00 am	ISM Index - Oct	51.6	<b>50.6</b>		52.0
<i>Sometime</i>	Domestic Auto Sales - Oct	5.1 Mil	<b>5.2 Mil</b>		4.9 Mil
<i>During the day</i>	Domestic Truck Sales - Oct	7.1 Mil	<b>7.1 Mil</b>		7.5 Mil
11-2 / 7:30 am	Non-Farm Payrolls - Oct	85K	<b>110K</b>		110K
7:30 am	Unemployment Rate - Oct	4.7%	<b>4.7%</b>		4.7%
7:30 am	Average Hourly Earnings	+0.3%	<b>+0.3%</b>		+0.4%
7:30 am	Average Weekly Hours - Oct	33.8	<b>33.9</b>		33.8
7:30 am	Manufacturing Payrolls - Oct	-10K	<b>-20K</b>		-18K
9:00 am	Factory Orders - Sep	+0.9%	<b>-0.4%</b>		-3.3%